UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

THE UNITED STATES OF AMERICA	)	
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	)	
	)	
vs.	)	CR No. 05-10019-RGS
	)	
	)	
DANIEL W. McELROY, AIMEE J. KING McELROY, and XIEU VAN SON	)	

BEFORE: THE HONORABLE RICHARD G. STEARNS

HEARING ON MOTIONS

John Joseph Moakley United States Courthouse
Courtroom No. 21
One Courthouse Way
Boston, MA 02210
Monday, October 17, 2005
2:38 P.M.

Cheryl Dahlstrom, RMR
Official Court Reporter
John Joseph Moakley United States Courthouse
One Courthouse Way, Room 3209
Boston, MA 02210
Mechanical Steno - Transcript by Computer

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P R O C E E D I N G S

THE CLERK: This is United States of America vs. Daniel McElroy, et al, Criminal 05-10019. Would all counsel please identify themselves for the record.

MR. LEVENSON: Good afternoon, your Honor. Paul Levenson for the United States. And with me is Jack Pirozzolo, also for the United States.

MR. DELINSKY: Stephen Delinsky for Dan McElroy. With me, my colleague, Andrew McConville.

02:42 MR ZALKIND: Jack Zalkind, your Honor, for Aimee McElroy.

MR. SMITH: Good afternoon, your Honor. Mark Smith for Xieu Van Son.

THE COURT: I have, I think, by counting, five motions that are pending. Mr. Delinsky, is there any particular order you'd like to proceed?

MR. DELINSKY: Yes, your Honor. I'd like to proceed on the motion to dismiss Count 1 first.

THE COURT: All right.

02:43 MR. ZALKIND: Your Honor, may I just ask that Mr. Delinsky argues in substance, may I be allowed to make a short rebuttal, if necessary, after the prosecution gives its opposition?

THE COURT: We can do that, understanding that we have only the afternoon.

MR. ZALKIND: I understand. When I say "short," I know what "short" means.

THE COURT: Okay. Good. All right. Motion to dismiss Count 1. This is on the alleged duplicity argument, right?

MR. DELINSKY: Correct. My understanding of a 371 conspiracy is that it can be proved by one or two means under the defraud clause or the commit clause. The argument that we have put forward is that, if the government alleged for the underlying conduct the same conduct, it could charge in the disjunctive both the commit and the defraud clause. And the jury could return a verdict of guilty on either one, and it would be a valid indictment.

What the government has done instead is to take the lesson from a 371 conspiracy and charge two distinct crimes: one, a Klein conspiracy to defraud the Internal Revenue Service out of its efforts in collecting proper taxes where the victim is the United States; and under the defraud clause -- rather, under the commit clause, charges mail fraud, alleging that the defendants essentially engaged in a scheme to defraud private insurance companies.

The government has alleged that there's an overarching conspiracy. The overarching conspiracy is that these companies and these defendants, through the use of false tax returns, defrauded the IRS and private insurance companies. But they

were different false tax returns. They are two different schemes and two different purposes.

As a result as to how the government has charged this case, the jury is faced with a dilemma because, instead of being able to decide in the alternative what clause has been violated by the defendants -- either the defraud or the commit clause -- for the same underlying conduct, i.e., how we used to charge in state court a bribery case. You could commit bribery under 268A or under 268A, B, by engaging in a whole series of

02:46 acts. But the underlying -- by having different effects. But the underlying behavior was identical.

Here the behaviors are separate, but it's charged in one conspiracy indictment. So, therefore, it is duplicitous because it charges two conspiracies in the same indictment by separating the underlying conduct. Consequently, the jury, if this is left unattended, could return a verdict of guilty by finding the defendant guilty of the Klein conspiracy but not guilty of the mail fraud conspiracy and vice versa. And that would put these defendants --

02:47 THE COURT: Isn't the essence of a conspiracy, though, an agreement? If the government proves an agreement that has as its object multiple crimes, can't the government charge that in a single count?

MR. DELINSKY: The government can prove -- has the right to allege in a conspiracy indictment various conduct and

various purposes. But I submit that the charging document can't allege in itself two separate crimes. In other words, otherwise, the defendant is defending in one case two separate underlying crimes as charged.

THE COURT: Doesn't almost every RICO conspiracy indictment charge multiple crimes?

MR. DELINSKY: Yes, but there are separate elements.

THE COURT: They conspired to do X, Y and Z?

MR. DELINSKY: Yes. But there are separate elements, and there are separate elements of a conspiracy indictment.

Here, as I read the case law, the case law says that you can allege a 371 conspiracy if the underlying conduct is the same. For example, if Mr. Levenson said that these defendants engaged in a Klein conspiracy, and in carrying out the Klein conspiracy they used the mails to commit mail fraud to defraud the United States by mailing in the false tax returns or something else, that is alleging the same acts under a 371 conspiracy under both prongs.

Here they've alleged under a 371 conspiracy a conspiracy to defraud the United States and a conspiracy to defraud private insurance companies. That's why there are two conspiracies alleged, I say, in violation of the case law. We cite the cases as to why it's a violation in the case law.

According to Mr. Levenson, the First Circuit hasn't specifically dealt with this; but according to the case law

that we have cited, that you have to allege in a 371 conspiracy -- to allege in the disjunctive both crimes, they have to be the same conduct because now, your Honor, whereas the jury could -- you could charge the jury, if it was the same underlying conduct, listen, this count has been charged in the alternative as a conspiracy to defraud and a conspiracy to commit. If you find that the defendant has committed either one beyond a reasonable doubt, they are guilty on Count 1.

Right now, because the underlying conduct is different and we don't know, I submit the jury, if this were allowed to go to the jury this way, would have to be charged that the defendants -- unless you find beyond a reasonable doubt on each prong that they're guilty beyond a reasonable doubt, they are not guilty. So, in other words, if you find beyond a reasonable doubt that they're guilty of prong one but not guilty of prong two, they are not guilty.

THE COURT: Wouldn't a simpler remedy be simply to submit a special verdict to the jury?

MR. DELINSKY: Well, I think it would also require a charge as to -- that they would have to be found guilty of both because there's two -- it's two underlying separate conducts alleged in the same indictment. In order to save a duplicitous indictment, as I understand a duplicitous indictment, the remedy is for the government to say I'm going to prove both. If I don't prove both, if I only prove one, they are not

guilty, or the government can recharge properly.

But I don't think the jury has a choice to say you're guilty of one but not guilty of the other and you're, in fact, guilty of Count 1. If it was the same underlying conduct, yes, because you can charge the same underlying conduct disjunctively because the case law says a 371 conspiracy allows you to prove the same conduct that I've alleged two different ways.

They've alleged two separate sets of conduct, with two separate victims, two separate frauds. They say that they are connected somehow, but they've alleged them differently. The government has said in its brief that they could have charged it in one count properly but they didn't. So, therefore, to me, either it should be dismissed or the remedy -- a possible remedy to save it is they have to prove both prongs beyond a reasonable doubt; and if they don't and only prove one or none, of course, the defendants would be found not guilty. That, in substance, is my argument on the motion to dismiss Count 1, Judge.

02:52 THE COURT: Mr. Levenson, I think Mr. Delinsky is saying he's willing to accept your representation that you're going to prove -- or at least are willing to see the jury instructed that they are required to find that both of these allegedly disparate crimes have been proved beyond a reasonable doubt to sustain a conviction on Count 1 if I follow the

argument.

MR. LEVENSON: Right. I don't agree with that. I think the Barbato case, or Barbato, cited in our papers, 471 F.2d 918, specifically addresses the issue of duplicity where you have multiple means of violating a single statute. And the tried and true remedy in this area is to instruct the jury that they must be unanimous as to what crime was committed.

You can't have a jury where half the jurors are persuaded that there was a Klein conspiracy, half were persuaded that there was a mail fraud and have a guilty verdict. But if a jury is instructed that you must be unanimous as to whether either prong or both was committed and on that basis they may return a verdict of guilty provided that they find a conspiracy substantially as alleged in Count 1 existed and that the defendants intentionally participated in it.

THE COURT: You lean more to my special verdict theory? You see it as a jury unanimity issue?

MR. LEVENSON: I see it entirely as a jury instruction issue. The case law, I think -- it's reviewed in the briefs, but I don't think there's much in the way of significant split. There's this one case, the Haga case, from the Fifth Circuit, from 1987, that supports the defendants' viewpoint in dictum, saying, you know, under a single count you may charge either conspiracy to defraud or conspiracy to commit offenses, but you

can't charge both. That's what the Fifth Circuit said in 1987.

Nobody has jumped on that band wagon; and, in fact, the issue wasn't squarely presented in that case because that was a case where the government charged a conspiracy to commit offenses, and the Court, sitting without a jury, found that there had been a conspiracy to defraud the United States. And the Court of Appeals said, if the government charged the offense clause, you can't return a verdict, and you can't convict a defendant on something that wasn't charged. They are not -- they are separate elements to the two prongs of 371.

02:55

But every other case that's addressed the issue and the one cited in the Bilzerian case from the Second Circuit or, to my way of thinking, this District Court case in United States vs. Levine, 750 F.Supp 1433, does a very good job of both summing up the state of the case law back in 1990 but, also, of weighing the factors that really inform this decision.

In effect, 371, like a lot of other statutes, presents the issue of do you break up a conspiracy into multiple counts and subject a defendant to, in effect, double the penalties, the multiplicity issue? Or do you consolidate it in a single count? And Levine says, to paraphrase crudely, given the choice of multiplying the potential punishments that somebody faces for what is essentially any crime or, alternatively, the need to make sure a jury is properly instructed so that you have both clear notice to the defendant as to the charges --

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and there's no issue about notice here -- and a clear instruction to the jury on unanimity.

So you don't have a risk of a half-and-half kind of verdict that, as between the two sets of risks, you have to default, in reading the statute, in favor of the view that says let's make sure we have a proper unanimous verdict. Let's not pile on multiple punishments for the same offense. And that proposition the First Circuit has squarely addressed and is clearly on board with that.

02:57 Going back, the Verricchia case was a good example, where, if you've got multiple firearms possessed on a single occasion, the First Circuit says that's an offense of possession. It's not 21 offenses of possession. Given the rule of levity, you don't interpret a statute to say, gosh, in committing this crime -- in this case we'd be saying, in entering into this agreement and committing at least one overt act, the First Circuit says, unless Congress has said otherwise clearly, you don't assume that by that single act and that single statute a defendant is, therefore -- or thereby

02:58 subjected to sort of this prism effect where in an instant the defendant has committed 21 offenses and faces 21 times as much punishment.

What we describe in this case is under-the-table payroll fraud. There's bells and whistles to it. Every case has them. It's essentially a scheme to run a business under

multiple headings or multiple storefronts, as it were, and to hide payroll from tax authorities and from the insurance authorities. It's a single unified scheme.

THE COURT: Your argument, in essence, is that we have one conspiracy with two distinct sets of victims?

MR. LEVENSON: Correct.

THE COURT: Okay.

MR. LEVENSON: And two objects that are neatly -- and that are both properly charged under the statute and are neatly outlined in the statute. I don't think we're any different from Barbato where it was a money laundering and they said they did money laundering both with intent to promote and intent to conceal. Either one of those prongs would have been sufficient to make out the crime. The First Circuit said you instruct the jury that they've got to be unanimous and the problem is solved.

MR. DELINSKY: You know, Judge, under the Barbato case, what was being alleged was the same conduct. Mr. Levenson cites the Bilzerian case, which is a Second Circuit case, decided in 1990. The relevant language in that case states, "Although it is recognized that the government may not obtain two convictions or punish the defendant twice for the same conduct, by alleging violations of both the defraud and offense clauses of the conspiracy, it may simultaneously prosecute the same conduct under both clauses." "The same

conduct under both clauses."

By the remedy suggested by Mr. Levenson, well, we're going to give a grab bag, the jury is going to have a choice of either mail fraud or a Klein conspiracy with two different victims. We'll have the same spillover effect, and we'll let the jury poison -- hear poison about one that wouldn't necessarily be admissible against the other and then they can decide. But they don't have to prove both.

And I say that where it's the same conduct it is disjunctive, and you can prove the same conduct by alternate means. The case law is ripe with that quote, "The same conduct by alternate means," not two different conducts, by two different means, and then giving the jury an either/or.

THE COURT: What is the clear distinction in conduct that you see?

MR. DELINSKY: The distinction is --

THE COURT: I understand the different sets of victims. But what is different in the conduct?

MR. DELINSKY: What is different is that under the Klein conspiracy it is alleged that the defendants submitted to the Internal Revenue Service false tax returns about the amount of -- about the numbers of workers that were being employed, and they submitted a lower number than in actuality. They only submitted the individuals who were receiving checks as opposed to individuals who were receiving cash; and, therefore, the IRS

was defrauded out of receiving the proper withholding and FICA insurance.

The fraud alleged, vis-a-vis the insurance companies, were that, in substance, the defendants, in order to achieve a lower premium for workmen's compensation insurance, submitted to the IRS tax returns which showed a lower number of employees on the payroll than actually occurred so that -- so they submitted documentation of alleged tax returns that were submitted to the Internal Revenue Service -- which, in fact, the government says -- were never submitted to the Internal Revenue Service -- which showed a fewer number of employees. Therefore, they would get a lower premium for unemployment.

The tax returns in question were different. The tax returns submitted to the Internal Revenue Service were different than the tax returns submitted to the insurance companies. Those are -- the commonality is the use of tax returns. That's it. And to say that both of those constitute the same conspiracy to defraud the United States is wrong. That's not the same underlying conduct. It's two separate conducts, and the government can't have it either/or. They can put it all in and let the jury decide. Let the government prove both beyond a reasonable doubt. They've charged it. They've charged it both ways. And if they want to keep the indictment, we'll take the risk of multiple punishments. But if they say it's -- then let them prove it.

As I understand duplicity, either they have the right to elect -- as I understand duplicity arguments, when I've dealt with them in the past, prior to the start of the trial, the government has a choice of electing which theory to go forward on. Or if they want to go forward on both, where there's different underlying conduct, they have to prove both beyond a reasonable doubt to get a conviction on Count 1. Otherwise, the indictment should be dismissed and let the government recharge; or they go forward, but they have to prove both beyond a reasonable doubt. Those are two separate crimes.

THE COURT: How would you distinguish this: You and I were corporate officers. We conspired to commit securities fraud. We overstate the amount of inventory. Now, in the process don't we -- we defraud shareholders. We defraud the market. We commit a crime against the SEC.

MR. DELINSKY: Correct. But it's the same underlying conduct. You would introduce the same underlying conduct of -- what you have done is you have understated your inventory deliberately so that there will be false financial statements that the market will rely on to invest in your public company. And that act that flows from that has various consequences.

These acts are two separate acts, two separate acts. They're not the same way to commit the same crime. Your example, I have no problem with because it's the identical conduct. This is two separate conducts, one involving the

Internal Revenue Service and one involving the private insurance. It's a different scheme. The government has alleged it's the same. As I read the case law, you can charge it disjunctively if it's the same conduct. I allege -- I think it's obvious on its face it's separate conduct; and, therefore, it is duplicitous. The remedy for duplicity is either a dismissal, an election, or the government proves both beyond a reasonable doubt.

MR. ZALKIND: Your Honor, I'll be very brief, but I think that in the government's brief you're going to find your answer. On Page 7 the government says that in the First Circuit, in the case of United States vs. Cloutier, the way that you distinguish on these single and multiple conspiracies is the similarities of the fraud involved, the coconspirators' objectives, the means used to achieve these ends, the similarities and difference in the evidence used to prove the conspiracy, and the identity of all persons involved. All together different in each one of these acts, your Honor.

In the case involving the IRS, it is two companies the McElroys had. They were legitimate companies, same officers. And the income tax returns, your Honor, were shown. They were different than what they should be. And as a result of that, the scheme was to lower the price of the insurance.

Now, in the other scheme where -- not to pay the taxes, it was entirely different. They set up -- according to

the government's allegations, they set up straw companies, straw corporations. They had straw managers. The straw managers did not pay the taxes. The straw managers changed their insurance policies every year so they wouldn't have to pay these high premiums.

And so when you look at the indictment, your Honor, the answer is right there. The acts that were committed to prove these two separate conspiracies is right there in this brief, your Honor. You can look at it all day long. And the

03:07 big serious problem that I see -- and I'm not going into the cases again -- is the prejudice involved that spills over. From one to the other in one case, your Honor, you have these workers that are not paying taxes, and the jury is going to say, oh, ghee, they didn't pay their taxes, and these people made money, et cetera, so forth and so on, which would never be allowed in in the scheme for the insurance company. And then by separating both of them, you don't get this tremendous prejudicial spillover, your Honor.

And I think that's my serious point that bothers me so

03:08 much in this case, your Honor. I don't see how you can -- sure, you can set up charges. But how do you stop the evidence every five minutes by saying you can't consider it on this one, but you can consider it on this one? I think it's a very serious point. The First Circuit recognized it, your Honor. That's my point. That's all I have to say on rebuttal.

THE COURT: Of course, that argument is premised on the notion that had the government, in fact, indicted two separate conspiracies it would be improper to join them for trial, am I right?

MR. ZALKIND: Yes.

THE COURT: You're going to have the same prejudice. Oddly enough, at the moment I'm trying a case that actually combines exactly the same two, a scheme against --

MR. ZALKIND: You say you tried 21 counts of gun conspiracy, but the way you buy it is the same. You may buy it from the same person, the mold.

These cases are -- when you read the indictment, they're so different. One is a simple plan to reduce the amount of taxes by various methods that you show that you did pay the taxes. You show it to the insurance company and say, okay, we'll lower the rates.

The other one you don't even do that. The other one has nothing to do with that. According to the government's allegations, we're not going to pay the taxes, and the way we do it is we won't pay the workers. The workers won't have to file a withholding. It's an entirely different scheme. I don't understand how they can put it in the same conspiracy, your Honor. The workers were being paid. It's the taxes that weren't being paid.

MR. DELINSKY: I have -- I think from my perspective,

as I understand the remedies for duplicity, other than dismissal -- and as I understand, duplicity is waived unless it's raised pretrial so the judge can make appropriate decisions. The remedies are a dismissal of the duplicitous charges; a government election as to which duplicity charge to go forward on; or the requirement to prove both elements. And if you prove one, it's insufficient. I think to prove one, I think, is very dangerous and very prejudicial and very unfair because then you would have linked in one count two separate charges, plus, in one trial, the underlying mail fraud counts with the underlying tax counts, which I think gives the government a very unfair advantage in contravention of the joinder and severance.

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03:11

THE COURT: If the jury is -- if we turn to your third alternative, aren't you walking right into Mr. Zalkind's argument? Now you're saying, no, it really can't be that prejudicial even though there's now going to be proof of both alleged conspiracies so long as the jury is told that you have to be convinced that both conspiracies, in fact, are proved beyond a reasonable doubt. I mean, what happens to the prejudice argument then?

MR. DELINSKY: Well, the prejudice argument, I think, is mollified greatly under that remedy because the jury is charged that they've got to prove both; whereas, if it's either/or, the use of the evidence to effect the proof of the

other is much more extreme. Whereas, the remedy to prove both, it's mollified because they've got to prove both. You can't use it, one piece of evidence to prove something else. So, therefore, if the evidence is in and they don't feel that the defraud clause has been proved, the whole indictment fails. So I think by having them to prove both, both beyond a reasonable doubt, it mollifies the prejudice argument.

The additional motion that I filed, the motion to sever some of the underlying counts, Judge, basically, that motion flows from the Court granting relief on Count 1 through a dismissal. Now, if the government elected, I suppose, to proceed on the -- under the defraud theory, I would ask that the commit substantive indictments also be severed. If the government is going to be proceeding under both and having to prove both, then I suppose all could go to trial. Or if they say no, then if the -- if the mail fraud -- I think what I'm suggesting is, if the cases are separated, all the insurance fraud cases -- counts should be tried together, the insurance fraud conspiracy with the mail frauds, and then the Klein conspiracy with all the tax -- with all the tax charges. That's a relatively simple argument that I think is primarily based upon the Court's decision in Count No. 1. So I would rest my argument on that.

THE COURT: Do we want to -- I'm sorry. I have so many motions. I'm trying to keep them straight here.

MR. DELINSKY: That is the misjoinder of offenses.

THE COURT: Right, misjoinder. Different issue than the challenge to the --

MR. DELINSKY: Than the duplicity. But the misjoinder --

THE COURT: And the mailings not being in furtherance of the scheme to defraud?

MR. DELINSKY: Well, the misjoinder is based upon the following argument: If the Court finds that the indictment is duplicitous that requires it to be dismissed, consequently, the substantive mail fraud and the substantive tax counts can't be tried together. That's the substance of that argument. Whereas, if the government elected to go forward on one prong under a duplicity analysis, the substantive counts that I suggest the government could try with that would be only the substantive counts connected to that prong. Whereas, if the government said, hey, we're going to prove both prongs of the conspiracy beyond a reasonable doubt, we failed to prove one, not guilty on Count 1, then I could see all counts being tried together. And as I read the remedies under duplicity, that that's how the courts have done it, that you've got to prove both.

THE COURT: Okay. Do we want to move to the motion to suppress?

MR. DELINSKY: Yes. Now, the argument on the mail

fraud, as to the furtherance, I'm relying on my brief for that. I don't propose to give any oral argument on that, your Honor.

MR. ZALKIND: I join my brother on that myself, your Honor.

MR. DELINSKY: The motion to suppress is based upon the following principle of search-and-seizure law that is quite elemental; that is, a warrant application must demonstrate probable cause to believe that a particular person has committed a crime, i.e., the commission element, and the

03:15 enumerated evidence relevant to the probable criminality likely is located at the place to be searched, the nexus element.

I contend that the search warrant in this case is fatal under both counts, the commission element and the nexus element. It's fatal under the commission element primarily because there's an abject failure of probable cause because of the immense staleness of the affidavit.

In substance, the government has alleged that a former employee of the defendants' from 1996 to 1998, observed the conduct of the companies and what they were engaged in. Gave

03:16 specific evidence, gave specific information to the government. He ceased his employment in 1998, had no further contact with the defendant, and then the defendants moved their location in 2000 to the current location where the search was executed in 2001.

So, therefore, the affidavit -- and I think Mr.

Levenson would agree -- absent Michael Powers, the averments related to him, there would be absolutely no probable cause at all. Where we disagree is to the level of corroboration and updating the information that Mr. Powers has provided and underlying facts dealing with the credibility of Mr. Powers that were excluded from the affidavit.

We have an individual supplying information that was the basis of an affidavit, signed, and the warrant obtained in June of 2001 when that informant's information ceased in May of 1998. You're talking a three-year gap, three years. Staleness many times is discussed in terms of months, weeks.

03:18

THE COURT: It depends on what you're looking for. There are cases involving, for example, pornography collections where 16 years has been thought not to be stale.

MR. DELINSKY: Well, in the case -- in one of the classic cases in this court, there was such a case, and they did obtain a warrant. And the Court of Appeals said that it was violative of a lack of probable cause, and it didn't get over the Leon good-faith requirement. That was a case tried a

03:19

number of years ago. It was a case decided in the 1980s, and I have the cite of the opinion. I believe it's cited in our brief.

But what allows old probable cause to rise to the level of sufficient probable cause for the issuance of a warrant is to what degree has that information been brought

current? The evidence that the government has put forward in the affidavit, in the form of alleged corroboration, that the scheme is ongoing, is remote at best.

The government cites the recent First Circuit case of Greenburg that talks about corroboration of an informant. Well, the important thing in the Greenburg case was that informant's information was corroborated contemporaneously by observations and actions that the United States took, and there was no gap in obtaining the search warrant, not based upon three years.

03:20

The other facts that the government cites -- and they make an issue about this because I contend, taken in and of themselves, it is evidence of innocent conduct -- the fact that checks were cashed. The government is not alleging any violations of the money laundering statute. There were proper CTRs filed. There was no attempt to hide. They're not alleging that that constituted a criminal act, the fact that people were coming and going from this location.

But, most importantly, the government states that in

03:21

19 -- I believe 1994, the Department of Labor issued an injunction against Aimee McElroy and on some counts -- some parts to Dan McElroy. But it's irrelevant as to how the obligations under that injunction applied to one and not the other. So for purposes of my argument, the injunction basically said that you can't pay your employees in cash. You

have to file proper records, proper tax returns, and you have to keep all of your records.

The government is saying that injunction is clear evidence that they had to maintain all of these records in their current location where the search and seizure was effectuated even though the informant has no idea what was kept in the new location because he left in 1998, three years before.

THE COURT: Wouldn't a better argument be -- since tax fraud is really the object of the search that was authorized, since the IRS requires you to keep three years of tax records in the event of audits, even fraudulent tax records, wouldn't it follow that assuming Powers was the only informant that three years later it would be likely that the same tax documents that you are looking for would be still in the defendants' possession?

MR. DELINSKY: No, not necessarily, because if the government alleges that there were crimes being committed, in fact, the opposite incentive would be to take place, because the government has alleged that they were violating the injunction for purposes of cash payroll, but at the same time, they were maintaining the injunction by keeping all of their required -- all of their required records.

I think something more is required, and that's where we get into the nexus element. The fact that you had probable

cause to say that in 1998 certain conduct was occurring, they move. There was no description as to where records were kept, what records were being kept at the new location, who was keeping the records, how their offices were laid out, all information that Powers knew in 1998 about an old location.

The government, in its affidavit, also talked about an off-storage location where records could be kept. Well, they never got -- they never executed any search warrant regarding an off-storage -- off-site location that they knew the McElroys had for storage of records.

03:24

The link between information in 1998 to information in 2001 that the fraud was ongoing and that the records would be at this new location is a great leap of faith. And when you look at the separate elements that the affidavit sets forward to show that this is ongoing, this is the evidence that it's ongoing, take each act, taken in and of itself, does not prove or does not rise to the level of refreshing probable cause and making it contemporaneous with the application for the search warrant.

03:25

Just to the contrary, the government has alleged that in 1997 one of the companies that the accountant, Charles Wallace, prepared tax returns for, one of the alleged sham companies that the government has put forward, didn't pay taxes, was subject to an IRS audit. And on behalf of the company, Mr. Wallace agreed to pay the back taxes and entered

into a partial payment agreement where, monthly, he paid the taxes. That doesn't prove a scheme to defraud.

The statement by Mr. Wallace in 1997 that some of the employees only wanted to be paid in cash, that does not prove that in 2001 that this same crime was occurring.

The other factor is, especially in light of the reliance so heavily on information geared to 1996 and 1998, the credibility of Powers is extremely important. The affidavit did not divulge important things about Mr. Powers; one, that he

03:26 came forward in 1999 to the state of Massachusetts because he was under investigation for misconduct involving a company that he had set up after he left the employ of the McElroys.

The government's argument is, well, we didn't find out about that until 2002. How did they not find out that he was under investigation until 2002 when he came forward in 1999? And the reason he came forward, according to his partner, was that he was under investigation. That's not disclosed. It's also not disclosed that at the time of the search warrant --

THE COURT: But all you're arguing is that they were

03:27 negligent in not learning that he was under investigation by another sovereign authority. Negligence just doesn't make it under Franks.

MR. DELINSKY: I understand that negligence doesn't make it under Franks. I'm not arguing this is negligence. I'm saying there's no way they could not have known. The agency

who they were working with, the Insurance Fraud Bureau, which is a creation of the Massachusetts legislature, funded by the private insurance industry, that agency was working with the very -- with the very agency that was investigating Powers. So the Insurance Fraud Bureau, which became an agent of the United States in this case, was the very agency working with the underlying state agency. Then, for the government to say, well, we didn't find out about it until 2002 when Powers' partner told us about it, and it was still pending, the investigation, I think that that rises to the level of at least an evidentiary inquiry under Franks as to whether a hearing should be held.

03:28

THE COURT: Perhaps. Remember, this is the government that didn't know a hurricane was headed for New Orleans.

MR. DELINSKY: That's correct, or that they felt that the -- that the levies were secure.

The argument also is that wasn't disclosed that Powers had an agreement for pocket immunity with the United States at the time of the affidavit; that -- and the Vigeant case, where the First Circuit overturned a search warrant, saying that it was a Leon violation when the affiant -- rather, when the informant, the person providing the information, when it wasn't disclosed of his ongoing criminal -- quasi-criminal issues with the United States, which was relevant, where it was so critical, his information, to the granting of probable cause in

03:29

the search warrant. We cite that in our brief.

There was another -- there was another element -- and I don't know how to deal with it because Mr. Levenson has dealt with it. In the plea agreement, it said that Powers is dealing with separate criminal charges. The government now has said, well, that was a misprint even though the government signed the letter, Mr. Powers signed the letter and his lawyer signed the letter, that it was a misprint, that he wasn't under any criminal charges, but he just signed a letter to that effect. I don't know. I'm not saying the government is misrepresenting any fact.

THE COURT: I don't think Mr. Levenson would misrepresent that to you. This is the evil of word processing. I get pleadings from lawyers all the time that don't change the name of the client from the last case. These are things that, unfortunately, technology makes it too easy for us in some ways.

MR. DELINSKY: I would hope before a defendant and his lawyer would sign a letter with the United States that they would read it.

THE COURT: One would.

MR. DELINSKY: Especially when it says that you're under criminal charges for another crime. But I take it for what it is.

Under the Leon exception, the exclusion for Leon good

faith is when a magistrate was misled by information in an affidavit that the affiant knew was false or would have known was false except for his reckless disregard for the truth; 2, where the issuing magistrate wholly abandoned his detached and neutral role; 3, where the affidavit is so lacking in indicia of probable cause as to render an official belief in its existence entirely unreasonable; and then 4, where a warrant is so factually deficient, i.e., in failing to particularize the place to be searched or the things to be seized, that the executing officers cannot reasonably presume it to be valid.

03:31

I suggest that for the search warrant, without dealing with the Franks hearing on prong one, on whether or not the affidavit should have disclosed more of the credibility issues relating to Michael Powers because it's so -- in this case it was so critical to the granting of that search warrant, is -- we're relying on prong three, where the affidavit is so lacking in indicia of probable cause as to render an official belief in its existence entirely unreasonable. That is the staleness argument.

03:32

The Franks argument, even though related to this, is a separate issue relating to the lack of substantiating material clearly available to the government that the magistrate should have had in front of him to determine the credibility of Michael Powers and his motive to lie.

So, one, we're contending that the affidavit is

fatally flawed because that the probable cause set forth is stale; and two, and most importantly, under the nexus element, because there was a change in location, there was nothing set forth in the affidavit based upon any information as to anybody having observed the new location, what was kept there, who worked there, and what files would be present and where, that I think that the nexus requirement that is required in a valid search warrant was violated. So there's both the staleness and the nexus requirement.

03:33 And then, lastly, the lack of substantiation for the failure to disclose serious credibility issues regarding Michael Powers that the magistrate should have had, I think we have met the burden under Franks for that, and there should be an evidentiary hearing.

MR. ZALKIND: Let me just add a remark. You said something before that's quite interesting. You said that, well, you're required to keep your records for taxes for three years. As a matter of fact, I'm working on a case right now, your Honor, where there's a nursing home under investigation,

03:34 and they sold their nursing home so that there were two different locations. And what they did was what they should have done here. They issued a subpoena. They issued a subpoena, and it's taken almost a year and a half to put all these records together.

So the government took a guess in this case, and they

guessed that since the business had moved from one place to the other the records were there. But as Mr. Delinsky says, there is absolutely no evidence whatsoever that the records that they were seeking were at this place, none whatsoever, Judge. And we had the same thing, as I'm saying, in this nursing home case. Because they had changed, the attorney general felt that the search warrant wouldn't be proper because they would have to guess that the records were there. And if they had issued a search warrant, P.S., they wouldn't have found them because they were in a storage bin elsewhere.

03:35

So I really think that's a very, very strong argument that Mr. Delinsky gives. Even though the records are required to be kept, it doesn't mean a damn thing. They don't have to be there at all, Judge.

THE COURT: Mr. Levenson.

MR. LEVENSON: I have to start -- I won't try and respond to each point that's been raised, but I do have to start with the first premise because I think it's wrong. Mr. Delinsky suggests that with absent Mr. Powers there's no problem cause here. I would suggest that Page 21 of the warrant affidavit, the chart at the top of it, by itself, lies somewhere between probable cause and proof beyond a reasonable doubt, at least as to the fact of commission of the offense.

03:35

If I can take a second just to direct the Court to what that is and what its significance is. It's a chart. At

the top it says, "Daily AK Labor, Inc." The left-hand column says, "DAK," Daily A. King, "audit dates," and shows the dates on which insurance company auditors were in to look at what they thought were the books of the company to find out what the company's payroll was.

As you'll see, the most recent of those audits by an insurance company auditor was October of 1999. That tells us two things: one, we're talking about conduct later in date than the period when Michael Powers worked there; and, two, that quite apart from Mr. Powers, as we work forward, we look at the time periods covered by the putative tax returns that were disclosed to the insurance auditors on those dates.

The next column shows how much payroll was reported to the insurance company; basically, 2 to $3 million a year for each of the periods in question. And in each period, the auditors were shown Forms 941, what appeared to be tax forms that appeared to corroborate those payroll figures that were reported to the insurance companies.

The right-hand column is the kicker. That's the IRS tax records as actually maintained by the IRS. And what this shows -- or what this summarizes is the evidence showing that the tax records shown to the insurance auditors were forgeries. They simply were not the same records. They were a forged version of the 941s for the same time frame.

So we're talking here about evidence of -- direct, all

but uncontrovertible, evidence at least as to commission. We may get into issues about intent. We may get into issues about who directed what. But as to the fact of commission and commission at a later date, probable cause is amply shown in the top of Page 21.

As for staleness, if we go to Page 25 of the application -- or of the warrant affidavit, this is simply a listing of CTRs. How much green cash is this company getting its hands on on an annualized basis? And bearing in mind that the affidavit is dated June of 2001, the 2001 entries now take us up to the first six months of 2001.

So, crudely put, what this chart shows is roughly 40 million, 39-million-plus, in green cash between 1997 and 2001, of which three million is from the first six months of 2001 alone, this from a company that was under a consent decree and injunction saying we will not pay our workers in cash, and we will keep records reflecting the hours worked, payments made and the other employment information as part of the enforcement of that consent decree.

So putting just that information into context, what we're talking about is ample probable cause. And I'm not suggesting -- we all know that our currency says legal tender for all debts, public and private. There's no law per se against obtaining cash, even if it's $39 million. But when you're under an injunction that says don't be paying your

workers cash and the same pattern continues of massive amounts of cash being obtained on a weekly basis, through the people who are the nominal owners, as described by Powers, we're talking about an uninterrupted pattern. When that, in turn, is corroborated by surveillance in April of 2001 -- if we go to Pages 31 and 32, you get a description of the April surveillance specifically linking Xieu Van Son who -- Mr. Smith actually represents Mr. Van Son -- describing Mr. Van Son's vehicle being sighted, going to the bank, a CTR from the same day from the bank and identifying Mr. Van Son as getting out $107,000 as a transactor for Precision Temp Corporation, which had been identified as one of the companies that the government alleges are shell companies. I understand the defense has a more benign explanation of their role.

03:40

But when we're talking about a commonsense probable cause determination, the premise that this is all Powers and nothing else doesn't hold up. The premise that this is all Powers talking about events back before the end of 1998 doesn't hold up. And the premise that there's nothing linking the current location, quite apart from the commonsense observations of the agent, that if you're running a $40 million or, in this case, roughly an $80 million temporary employment agency, 80 million being about 40 million paid legitimately by check, the other 40 million under the table in the time period, it's not an unreasonable proposition that if you're running an $80

03:41

million business you probably keep records, particularly if you're under order and consent decree requiring you to keep such records.

It certainly is not an unreasonable proposition, as you've pointed out, that as to your tax records, you at least keep the last three years. And since we're talking about conduct that continues well into that three-year window, given the nature of the conduct, the consistency of the scheme, the shear amount of currency involved, and the updating of the probable cause, this just is -- this is not a close case. This is one where the probable cause was ample.

You know, I commend defendants' counsel in scouring the early discovery that was provided and early Jencks to find arguable inconsistencies or arguable claims. I think they strained the limits of creativity in saying that Powers says when he left Mr. McElroy said, well, don't talk to my people, and they say, well, clearly, he didn't talk after that, that was a threat, I don't follow their logic. But they clearly have scoured for any arguable omissions from this affidavit. And apart from my word processing dereliction, where I have to admit probably not the only one in my career, they don't have anything.

The information provided by Mr. Powers had been provided before he got his immunity letter. There's nothing about the immunity letter, unlike the Vigeant case, where

you're talking about an unnamed, unidentified, confidential informant as to whom there was a -- the First Circuit, at 176 F.3d 573, describing the failure to mention this unnamed, unidentified confidential informant's long criminal history, numerous aliases, recent plea agreement, meaning admission to criminal conduct and other indicia of unreliability.

Here, to the -- the key factors that would underlie any evaluation of Mr. Powers' credibility or motive are, namely, a), he was involved in criminal conduct and clearly was looking to point the finger at others; and, b), he was a competitor. Those facts are disclosed in the affidavit. The suggestion that the 40-page affidavit should have been longer, to include everything in all of the 302s that were ultimately turned over, I think, strains credibility on this one.

MR. DELINSKY: Just a couple of points, Judge. Vis-a-vis Mr. Powers, I have no statement in a 302 form involving Mr. Powers that predates his immunity agreement with the United States. In fact, his cooperation began in 2000 with the signing of that agreement. Maybe he cooperated with somebody else beforehand, but I have no statement, no affidavit, no 302s from the FBI or IRS that predate that. And if he did, I haven't been given those copies of any statement.

And with respect to the tax returns, well, the government didn't have any problem finding tax returns. They got them from the insurance companies. It got them from the

Internal Revenue Service. The allegation that somehow, because the government has said that in 1999 they have evidence that the insurance companies received tax returns different than what was filed for the same entity for the IRS in 1999, somehow proves that in 2001 evidence -- records evidencing a crime will be present in a different location than Powers was in in 1998, I think, is stretching the limits of staleness and the requirements of the warrant requirement.

The Court before, earlier today, referred to a case where, in an obscenity case, you can go 14 years. The case is United States vs. Ricciardelli. It was decided by the First Circuit Court of Appeals on June 22, 1993. And in that case the Court of Appeals overturned a search warrant post-Leon where the information that was used to obtain an anticipatory search warrant was 14 years old.

So, yes, they can go back and use old evidence, but they have to also meet additional requirements under the Fourth Amendment that requires affidavits to be based upon probable cause and that there be a link between the probable cause and the location to be searched and that important information regarding the underlying believability or credibility of an informant, where it so heavily and overwhelmingly relies upon him, that is excluded from an affidavit, I think, coupled with all that, at least requires an evidentiary hearing. But I think, on its face, the staleness argument has been met.

THE COURT: We may be meandering off in the pornography collections that aren't really quite relevant to this case. Ricciardelli, the real issue in that case was whether the -- in an anticipatory warrant, the warrant has to identify the triggering event.

MR. DELINSKY: Correct.

THE COURT: That gives the officer then the right to serve the warrant. That's an issue the Supreme Court is going to be taking up quite shortly.

03:49 MR. LEVENSON: Just on a factual matter, Mr. Delinsky was talking about evidence of prior involvement of Powers making statements before the first 302 that he's received. That's set forth in the affidavit. It's at Page 7, Paragraph 15, describing Powers' first coming forward to the Insurance Fraud Bureau in 1999 and describing what he came forward with. So that's where that can be found in the record.

And the other point that I think is important -- and I understand how significant it is for the defendants to try and show some discontinuity between activity at the time Powers was

03:49 involved and later activity. The important point from our perspective is the commonality, that the description of Charles Wallace's involvement not only by Powers but by Ms. Bova, the tax examiner, who met with Wallace and heard admissions from Wallace about paying employees in cash, the fact that Wallace is identified in the surveillance is shown to still be by all

appearances -- you know, obviously, there isn't a new informant inside the organization. These are the appearances one derives from corroborating who's going to the bank, who's carrying the satchel and how much money is being taken out of the bank, in whose name, on what day. But that's precisely the kind of information that one always constructs probable cause from. But the continuity of the act -- not merely the actions but the actors -- is, I think, the important point.

MR. DELINSKY: Again, just without belaboring, that interview with Wallace, as I recall, as set forth in the affidavit, occurred in 1997.

THE COURT: Interesting issues to think about. Pending the decisions that I reach on these motions, is the case otherwise ready for trial? Are we toward an ultimate event or --

MR. DELINSKY: Well, we have to work through -- and I'm confident that Mr. Levenson and the defense counsel will be able to work through some ongoing discovery matters to simplify the trial. But I would suspect -- maybe Mr. Levenson can indicate one way or the other -- but looking at a March or April trial date.

THE COURT: So there is no pressure on me to turn these around in the next week, in other words?

MR. DELINSKY: No, no, absolutely not.

MR. LEVENSON: To phrase it differently, other than

the 30-day limit the First Circuit imposes, but if we've got the Speedy Trial -- if defendants' remarks are taken and can be memorialized to reflect that the Speedy Trial Act is not a problem, I agree wholeheartedly.

THE COURT: At least not a problem until next March, is the date you're looking for, right?

MR. DELINSKY: I think Mr. Levenson and I -- I think -- I'm just thinking practically of when the earliest time would be when this case could be reached in order to resolve or potential conferences with the Court. Whether or not there would be additional motion practice based upon discovery issues, I anticipate not. Hopefully, we can make agreements regarding documents to make this case run smoothly. I would think that the earliest that this case would be ready for trial would be sometime March. You tell me, Mr. Levenson.

MR. LEVENSON: I agree with Mr. Delinsky, that the interests of justice and of efficiency support -- and Mr. Delinsky is a very zealous advocate, but he's also a very pragmatic man. And as we have worked with discovery matters, we have been able to reach agreements on a great deal. We reach agreements by the government agreeing to turn over things that we otherwise wouldn't, but that's simply a credit for Mr. Delinsky's advocacy. The fact is, we get things done, and we're able to bring the case to court in better shape for trial on the true contested issues, I think, with the additional

time.

THE COURT: I don't intend to be tardy, but the issues are interesting enough that I'd rather not rush through them.

MR. DELINSKY: I can't speak for Mr. Zalkind, but there is -- to the degree it is necessary, in order to facilitate the Court's thorough review, I am basically stating that the time that the Court considers these motions be totally excluded from any Speedy Trial calculation as excludable time. I will so stipulate.

03:54 THE COURT: All right. If that's agreeable with counsel, then, I think that's --

MR. ZALKIND: No problem, your Honor. I tried to save the Court a lot of time. Obviously, if Mr. Delinsky says something and I don't agree with it, I'll stand right up.

THE COURT: I believe you would. It's agreeable to you?

MR. SMITH: Yes, your Honor.

THE COURT: All right. I'll take the matters under advisement. Thank you. Interesting.

03:54 (Whereupon, at 3:52 p.m. the hearing concluded.)

C E R T I F I C A T E

I, Cheryl Dahlstrom, RMR, and Official Reporter of the United States District Court, do hereby certify that the foregoing transcript, from Page 1 to Page 42, constitutes, to the best of my skill and ability, a true and accurate transcription of my stenotype notes taken in the matter of Criminal Action No. 05-10019, The United States of America vs. Daniel W. McElroy, et al.

/s/ Cheryl Dahlstrom

Cheryl Dahlstrom, RMR

Official Court Reporter